

## Internal Revenue Service

Number: **200938006**

Release Date: 9/18/2009

Index Number: 61.00-00, 817.00-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:FIP:B04

PLR-100956-09

Date:

June 17, 2009

### Legend

State 1 =

Fund =

Trust =

Adviser =

Adviser's Parent =

Dear

This is in response to the letter submitted by your authorized representative dated December 31, 2008, requesting rulings concerning the tax ownership of Fund shares.

### **Facts:**

Fund is a newly formed series of Trust, an open-end investment company which is a statutory trust formed under the laws of State 1. Fund's annual accounting period will be the year ended December 31. Fund intends to use the accrual method of accounting for maintaining its books and filing its federal income tax returns.

Trust is registered with the Securities and Exchange Commission (the SEC) as an open-end management investment company under the Investment Company Act of 1940, as amended (the "1940 Act"). Trust may issue an unlimited number of shares of beneficial interest with a par value of \$0.001 per share in Fund. The shares of

beneficial interest of Fund will be, registered under the Securities Act of 1933, as amended.

Shares of Fund will be offered to insurance company segregated asset accounts to serve as an investment vehicle for variable life insurance policies and variable annuity contracts (Variable Contracts) and to other regulated investment companies advised by the Adviser or an affiliate of the Adviser that are offered to insurance company segregated asset accounts to serve as an investment vehicle for Variable Contracts (each, a Related Variable Fund and collectively, the Related Variable Funds). Except as otherwise permitted by § 1.817-5(f)(3) of the Income Tax Regulations and except for shares held by a Related Variable Fund, all of the shares of Fund and all of the shares the Related Variable Funds will be held by one or more segregated asset accounts of one or more insurance companies and public access to Fund and the Related Variable Fund will be available exclusively through the purchase of a variable contract within the meaning of § 817(d) of the Internal Revenue Code of 1986, as amended (the "Code").

Although the terms of each Variable Contract may vary, the insurance company will generally hold the premiums paid by the Variable Contract holder, net of any fees or commissions, and any income earned on the net premiums in a segregated asset account. The Variable Contract holder generally will be able to allocate amounts held in the segregated asset account among several different investment options or subaccounts. At least one subaccount will correspond to an investment in a particular Fund.

Fund intends to enter into an investment advisory agreement with Adviser. Adviser is a limited liability company organized under the laws of State 1 and is registered as an investment adviser under the Investment Advisers Act of 1940, as amended. Pursuant to the investment advisory agreement, Adviser will be responsible for managing the investment and reinvestment of the assets of Fund in accordance with Fund's investment objectives, policies and restrictions, which are set forth in Fund's prospectus and statement of additional information, and administering Fund's affairs. To the extent requested by and subject to the supervision of Trust's Board of Trustees. Adviser is a direct subsidiary of Adviser's parent, a publicly traded company with principal operations in the financial asset management business.

Fund seeks long term growth of capital with a secondary emphasis on income. Fund currently expects to seek to achieve its investment objective by investing in the following asset categories: core, alpha and alternative. The core category seeks to provide market-like exposure by investing in a broad range of traditional asset classes, such as large-, mid-, and small-cap U.S. and non-U.S. stocks, growth and value stocks and investment-grade bonds. The alpha category seeks to generate higher-than-market returns on a risk-adjusted basis by investing in a broad range of traditional asset classes, such as large-, mid-, and small-cap U.S. and non-U.S. stocks, growth and value stocks, emerging market stocks, investment-grade bonds and high-yield bonds. The

alternative category is comprised of non-traditional investments with historically low correlation to the assets in the core and alpha categories, such as exchange-traded notes, investments with hedge fund strategy exposure, commodities-related securities, real estate securities, and structured products.

In order to gain exposure to these asset categories, Fund intends to invest in other regulated investment companies, including regulated investment companies advised by Adviser, and other pooled investment vehicles, including without limitation exchange traded funds (ETFs), (whether or not such pooled investment vehicles qualify as regulated investment companies) that emphasize these asset categories (Underlying Funds). Certain of Underlying Funds in which Fund will invest may be Related Variable Funds (all of the shareholders of which, except as otherwise permitted by § 1.817-5(f)(3) of the Income Tax Regulations, will be one or more segregated asset accounts of one or more insurance companies and other Related Variable Funds). There are currently, however, only a limited number of Related Variable Funds that provide exposure to specific asset categories that Fund desires. In order to obtain exposure to specific asset categories for which Related Variable Funds are not available and in order to more effectively execute Fund's investment strategies, Fund may invest in regulated investment companies and other pooled investment vehicles, including without limitation hedge funds and ETFs, that are available to investors other than through the purchase of a Variable Contract (Public Funds). Some of the Public Funds in which Fund may invest are advised by investment advisers other than Adviser or an affiliate of Adviser. It is possible that up to one hundred percent (100%) of Fund's total assets may be invested in Public Funds.

The portfolio managers of Fund will regularly review Fund's investments (including investments in Underlying Funds) and adjust Fund's investments in seeking to take advantage of current or expected market conditions or to manage risk. In making their investment decisions, the portfolio managers use a proprietary mix of qualitative and quantitative inputs to arrive at a view for the securities markets and segments of those markets. Based on the desired exposure to a particular investment and a thorough risk analysis, the portfolio managers then decide which funds to use as Underlying Funds and what proportion of Fund's assets allocated to an Underlying Fund changes over time and there can be no expectation that current or past positions in an Underlying Fund will be maintained in the future.

Other than a Variable Contract holder's ability to allocate premiums and transfer amounts in the insurance company segregated asset account to and from the insurance company subaccount corresponding to Fund, all investment decisions concerning Fund are made by Adviser in its sole and absolute discretion. A Variable Contract holder is not able to direct Fund's investments in any particular asset or recommend a particular investment or investment strategy, and there is no agreement or plan between the Adviser and a Variable Contract holder regarding a particular investment. A Variable Contract holder will have no current knowledge of Fund's specific assets. Fund's

portfolio holdings, however, will be available on a delayed basis on the Fund's website and in quarterly filings with the SEC, including annual and semi-annual reports to shareholders. A Variable Contract holder will have no legal, equitable, direct or indirect interest in any of the assets of Fund. Rather, a Variable Contract holder will have only a contractual claim against the insurance company offering the Variable Contract to receive cash from the insurance company pursuant to the terms of the specific Variable Contract.

Fund will comply with the diversification requirements of § 817(h) and, in accordance with those requirements, will treat each Public Fund as a single investment. Pursuant to such requirements, no more than fifty-five percent (55%) of the value of Fund's total assets will be represented by any one investment, no more than seventy percent (70%) of the value of Fund's total assets will be represented by any two investments, no more than eighty percent (80%) of the value of Fund's total assets will be represented by any three investments and no more than ninety percent (90%) of the value of Fund's total assets will be represented by any four investments. Furthermore, Fund will treat the segregated asset accounts underlying the Variable Contracts as shareholders of Fund for purposes of the information return requirements of § 6042 and the excise tax imposed under § 4982 unless the Variable Contract holders are treated as the shareholders of Fund pursuant to the investor control requirements discussed below.

**Representations:**

In addition to the facts presented above, the following representations have been made:

- (a) Trust is registered under the 1940 Act as an open-end management investment company.
- (b) Fund is a separate series of Trust, is a "fund" as such term is used in § 851(g)(2) of the Code, and is treated as a separate corporation for federal income tax purposes pursuant to § 851(g)(1) of the Code.
- (c) Fund will elect to be taxed as a regulated investment company under Part I of Subchapter M of the Code, and intends to qualify for the tax treatment afforded regulated investment companies under the Code for each of its taxable years.
- (d) Except as otherwise permitted by § 1.817-5(f)(3) of the regulations, all of the beneficial interests in Fund will be held directly or indirectly by one or more segregated asset accounts of one or more insurance companies and public access to Fund is available exclusively through the purchase of a variable contract within the meaning of § 817(d).
- (e) Except as otherwise permitted by § 1.817-5(f)(3) of the regulations, all of the beneficial interests in the Related Variable Funds are held directly or indirectly by

one or more segregated asset accounts of one or more insurance companies and public access to the Related Variable Funds is available exclusively through the purchase of a variable contract within the meaning of § 817(d).

- (f) The life insurance companies whose segregated asset accounts will hold shares of Fund will be life insurance companies within the meaning of § 816(a).
- (g) The life insurance companies whose segregated asset accounts hold shares of Related Variable Funds are life insurance companies within the meaning of § 816(a).
- (h) Each segregated asset account that will hold shares of Fund will be a separate account registered with the SEC as a unit investment trust under the 1940 Act.
- (i) Each segregated asset account that holds shares of the Related Variable Funds is a separate account registered with the SEC as a unit investment trust under the 1940 Act.
- (j) Fund will satisfy the diversification requirements of § 817(h) and § 1.817-5(b) of the regulations.
- (k) There is not, and there will not be, any arrangement, plan, contract or a agreement between Advisor and a Variable Contract holder regarding the availability of Fund as a subaccount under the Variable Contract, or the specific assets to be held by Fund or an Underlying Fund.
- (l) Other than a Variable Contract holder's ability to allocate Variable Contract premiums and transfer amounts in the insurance company segregated asset account to and from the insurance company subaccount corresponding to Fund, all investment decisions concerning Fund will be made by Adviser in its sole and absolute discretion. The percentage of a Fund's assets invested in a particular Public Fund will not be fixed in advance of any Variable Contract holder's investment and will be subject to change by Adviser at any time.
- (m) A Variable Contract holder will not be able to direct a Fund's investment in any particular asset or recommend a particular investment or investment strategy, and there is not, and will not be, any agreement or plan between Adviser and a Variable Contract holder regarding a particular investment of Fund.
- (n) No Variable Contract holder will be able to communicate directly or indirectly with Adviser concerning the selection, quality or rate of return on any specific investment or group of investments held by Fund.

- (o) A Variable Contract holder will not have any current knowledge of Fund's specific assets. A Variable Contract holder only will have a contractual claim against the insurance company to receive cash from the insurance company under the terms of his or her Variable Contract.

### **Ruling Requested:**

Fund respectfully requests a ruling that the Fund's investment in Public Funds will not cause the Variable Contract holders to be treated as the owners of the Fund's shares for federal income tax purposes.

### **Law and Analysis:**

Section 61(a) provides that the term "gross income" means all income from whatever source derived, including gains derived from dealings in property, interest and dividends.

A long standing doctrine of taxation provides that "taxation is not so much concerned with the refinement of title as it is with actual command over the property taxed – the actual benefit for which the tax is paid." Corliss v. Bowers, 281 U.S. 376 (1930). The incidence of taxation attributable to ownership of property is not shifted if the transferor continues to retain significant control over the property transferred, Frank Lyon and Company v. United States, 435 U.S. 561 (1978); Commissioner v. Sunnen, 333 U.S. 591 (1948); Helvering v. Clifford, 309 U.S. 331 (1940), without regard to whether such control is exercised through specific retention of legal title, the creation of a new equitable but controlled interest, or the maintenance of effective benefit through the interposition of a subservient agency. Christoffersen v. United States, 749 F.2d 513 (8th Cir. 1984).

Rev. Rul. 77-85, 1977-1 C.B. 12, considers a situation in which the individual purchaser of a variable annuity contract retained the right to direct the custodian of the account supporting that variable annuity to sell, purchase and exchange securities or other assets held in the custodial account. The purchaser also was able to exercise an owner's right to vote account securities either through the custodian or individually. The Internal Revenue Service (the "Service") concluded that the purchaser possessed "significant incidents of ownership" over the assets held in the custodial account. The Service reasoned that if a purchaser of an "investment annuity" contract may select and control the investment assets in the separate account of the life insurance company issuing the contract, then the purchaser is treated as the owner of those assets for federal income tax purposes. Thus, any interest, dividends or other income derived from the investment assets are included in the purchaser's gross income.

In Rev. Rul. 80-274, 1980-2 C.B. 27, the Service, applying Rev. Rul. 77-85, concluded that, if a purchaser of an annuity contract may select and control the certificates of deposit supporting the contract, then the purchaser is considered the owner of the certificates of deposit for federal income tax purposes. Similarly, Rev. Rul. 81-225, 1981-2 C.B. 12, concludes that investments in mutual fund shares to fund annuity contracts are considered to be owned by the purchaser of the annuity contract if the mutual fund shares are available for purchase by the general public. Rev. Rul. 81-225 also concludes that, if the mutual fund shares are available only through the purchase of an annuity contract, then the sole function of the fund is to provide an investment vehicle that allows the issuing insurance company to meet its obligations under its annuity contracts and the mutual fund shares are considered to be owned by the insurance company. Finally, in Rev. Rul. 82-54, 1982-1 C.B. 11, the purchaser of certain annuity contracts could allocate premium payments among three funds and had an unlimited right to reallocate contract value among the funds prior to the maturity date of the annuity contract. Interests in the funds were not available for purchase by the general public, but were instead only available through the purchase of an annuity contract. The Service concludes that the purchaser's ability to choose among general investment strategies (for example, between stock, bonds or money market instruments) either at the time of the initial purchase or subsequent thereto, did not constitute control sufficient to cause the contract holders to be treated as the owners of the mutual fund shares.

In, Christoffersen v. United States, *supra*, the Eighth Circuit considered the federal income tax consequences of the ownership of the assets supporting a segregated asset account. The taxpayers in Christoffersen purchased a variable annuity contract that reflected the investment return and market value of assets held in an account that was segregated from the general asset account of the issuing insurance company. The taxpayers had the right to direct that their premium payments be invested in any one of six publicly traded mutual funds. The taxpayers could reallocate their investment among the funds at any time. The taxpayers also had the right upon seven days notice to withdraw funds, surrender the contract, or apply the accumulated value under the contract to provide annuity payments.

The Eighth Circuit held that, for federal income tax purposes, the taxpayers, not the issuing insurance company, owned the mutual fund shares that funded the variable annuity. The court concluded that the taxpayers surrendered few of the rights of ownership or control over the assets of the subaccount that supported the annuity contract. According to the court, "the payment of annuity premiums, management fees and the limitation of withdrawals to cash [did] not reflect a lack of ownership or control as the same requirements could be placed on traditional brokerage or management accounts." Thus, the taxpayers were required to include in gross income any gains, dividends or other income derived from the mutual fund shares.

Section 817, which was enacted by Congress as part of the Deficit Reduction Act of 1984 (Pub. L. No. 98-369) (the “1984 Act”), provides rules regarding the federal income tax treatment of variable life insurance and annuity contracts. Section 817(d) of the Code defines a “variable contract” as a contract that provides for the allocation of all or part of the amounts received under the contract to an account that, pursuant to state law or regulation, is segregated from the general asset accounts of the company and that provides for the payment of annuities, or is a life insurance contract. In the legislative history of the 1984 Act, Congress expressed its intent to deny life insurance treatment to any variable contract if the assets supporting the contract include funds publicly available to investors:

The conference agreement allows any diversified fund to be used as the basis of variable contracts so long as all shares of the funds are owned by one or more segregated asset accounts of insurance companies, but only if access to the fund is available exclusively through the purchase of a variable contract from an insurance company. . . . In authorizing Treasury to prescribe diversification standards, the conferees intend that the standards be designed to deny annuity or life insurance treatment for investments that are publicly available to investors. . . .

H.R. Conf. Rep. No. 98-861, at 1055 (1984).

Section 817(h)(1) of the Code provides that a variable contract based on a segregated asset account shall not be treated as an annuity, endowment, or life insurance contract unless the segregated asset account is adequately diversified in accordance with regulations prescribed by the Secretary of the Treasury. If a segregated asset account is not adequately diversified, income earned by that segregated asset account is treated as ordinary income received or accrued by the policyholders.

Approximately two years after the enactment of § 817(h), the Treasury Department issued proposed and temporary regulations prescribing the minimum level of diversification that must be met for an annuity or life insurance contract to be treated as a variable contract within the meaning of § 817(d). The preamble to the temporary regulations stated as follows:

The temporary regulations... do not provide guidance concerning the circumstances in which investor control of the investments of a segregated asset account may cause the investor, rather than the insurance company, to be treated as the owner of the assets in the account. For example, the temporary regulations provide that in appropriate cases a segregated asset account may include multiple sub-accounts, but do not specify the extent to which policyholders may direct their investments to particular sub-accounts without being treated as owners of the underlying assets. Guidance on this and other issues will be provided in regulations or revenue rulings under § 817(d), relating to the definition of variable contracts.



51 Fed. Reg. 32633 (Sept. 15, 1986).

The final regulations adopted, with certain revisions not relevant here, the text of the temporary regulations.

In Rev. Rul. 2003-91, 2003-2 C.B. 347, a variable contract holder did not have control over segregated account assets sufficient for the Service to deem the variable contract holder the owner of the assets. The variable contracts at issue were funded by a separate account that was divided into twelve (12) subaccounts. The issuing insurance company could increase or decrease the number of subaccounts at any time, but there would never be more than twenty (20) subaccounts available under the contracts. Each subaccount offered a different investment strategy. Interests in the subaccounts were available solely through the purchase of a variable life or variable annuity contract that qualified as a variable contract under § 817(d). The investment activities of each subaccount were managed by an independent investment adviser. There was no arrangement, plan, contract, or agreement between the contract holder and the issuing insurance company or between the contract holder and the independent investment adviser regarding the availability of a particular subaccount, the investment strategy of any subaccount, or the assets to be held by a particular subaccount. Other than a contract holder's right to allocate premiums and transfer funds among the available subaccounts, all investment decisions concerning the subaccounts were made by the issuing insurance company or the independent investment adviser in their sole and absolute discretion. A contract holder had no legal, equitable, direct or indirect interest in any of the assets held by a subaccount but had only a contractual claim against the issuing insurance company to collect cash in the form of death benefits or cash surrender values under the contract. The Service concluded that, based on all the facts and circumstances, the contract holder did not have direct or indirect control over the separate account or any subaccount asset, and therefore the contract holder did not possess sufficient incidents of ownership over the assets supporting the variable contracts to be deemed the owner of the assets for federal income tax purposes.

### **Analysis:**

In the revenue rulings discussed above, the Service took the position that if the holder of a variable life insurance policy or variable annuity contract possesses sufficient incidents of ownership over the assets supporting the policy or contract, the contract holder is viewed for federal income tax purposes as the owner of the underlying assets and, as a result, is currently taxed on any income and gains attributable to the underlying assets. The Service stated in Rev. Rul. 2003-91 that the determination of whether the holder of a variable life insurance policy or variable annuity contract possesses sufficient incidents of ownership over the assets of the separate account underlying the variable life insurance contract or variable annuity contract depends on all the relevant facts and circumstances.

In the present case, the fact that Fund may invest in Public Funds does not cause the Variable Contract holders to be treated as the owners of the Fund's shares for federal income tax purposes. In Rev. Rul. 82-54, the amounts held in the segregated asset account underlying a variable contract were invested as the contract holder directed in shares of any or all of three open-end investment companies ("mutual funds"). Each mutual fund represented a different broad, general investment strategy. Shares of the mutual funds were available only to insurance company segregated asset accounts. While the mutual funds themselves were not available to the general public, the mutual funds held common stocks, bonds and money market instruments, all of which were available for purchase by members of the general public. The public availability of the assets held by the mutual funds did not lead to the conclusion that the issuing insurance company was simply a conduit between the contract holders and their mutual funds or the underlying assets of the mutual funds. Instead, Rev. Rul. 82-54 held that the insurance company, not the contract holders, was the owner of the mutual fund shares.

Similar to the facts in Rev. Rul. 82-54 and Rev. Rul. 2003-91, Fund will be available only to insurance company segregated asset accounts (or other permissible investors specified in § 1.817-5(f)(3) of the regulations) and will invest in assets that are available to the general public. In the current case, instead of investing in common stocks, bonds and money market instruments that are available to the general public, Fund will invest in regulated investment companies and other pooled investment vehicles, including ETFs, that are available to the general public. Based on the representations and facts presented by the taxpayer, the Variable Contract holder in this case does not appear to have any more control over the assets held under their contract than was the case in Rev. Rul. 82-54 and Rev. Rul. 2003-91. Based on the representations presented by the taxpayer, Fund is not an indirect means of allowing a Variable Contract holder to invest in a Public Fund.

**Conclusion:**

Based on the authority cited above and the representations and facts presented by the taxpayer, Fund's investment in Public Funds will not cause the Variable Contract holders to be treated as the owners of Fund's shares for federal income tax purposes.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by the adoption of temporary or final regulations, to the extent the regulations are

inconsistent with any conclusion in the letter ruling. See § 11.04 of Rev. Proc. 2009-1, 2008-1 I.R.B. 1, 48. However, when the criteria in § 11.06 of Rev. Proc. 2009-1, 2009-1 I.R.B. 1, 49, are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

/S/

DONALD J. DREES, JR.  
Senior Technician Reviewer, Branch 4  
(Financial Institutions & Products)